MEMORANDUM FOR: DCI

RE: NSC on Senate Bill 812, 1100 Tuesday, 29 October 1985

John will be going to this NSC meeting as you will be at NSA, and preparing for your appearance before the Senate Judiciary Committee.

Nevertheless, as this NSC addresses the President's powers to bar lending by U.S. institutions to "controlled" countries, I thought you would like to see the attached package which [redacted] has prepared. 25X1

Specifically, you should scan [redacted] covering memo and the draft talking points at Tab A. Thus, if you have any comments or suggestions re what position you want John to take, you can let him know. 25X1

[redacted] 25X1

Date 28 October 1985

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The Director of Central Intelligence

Washington, D.C. 20505

National Intelligence Council

NIC 05356-85
25 October 1985

MEMORANDUM FOR: Director of Central Intelligence
Deputy Director for Central Intelligence

FROM: [redacted] 25X1
Acting National Intelligence Officer for Economics

SUBJECT: NSC Meeting on Senate Bill 812

1. On Tuesday, 29 October, the President will chair an NSC meeting to determine the Administration's position on S. 812, the Financial Export Control Act, which would give the President powers to bar lending by US institutions to "controlled" countries.

2. Senators Garn and Proxmire proposed S. 812 (Attachment B) as a way of preventing the Soviet Bloc from using funds borrowed in the United States to finance the transfer of technology or to fund other activities such as support for Nicaragua. The bill was introduced on 28 March after elements contained in it were deleted from the Export Administration Act.

3. In terms of substance, it would, of course, be impossible to craft legislation to stop US funds from flowing indirectly to the Bloc. The Justice Department argues that provisions in the bill would allow the President to avoid excessive use of the Emegency Powers Act (IEPA), invoked for the Nicaragua sanctions. Others within the Administration argue that the President ought to have the power to take actions short of those under IEPA if the situation warrants, even if those actions only send a strong political message.

4. We have at least two points to make as input to any discussions of S. 812:

-- This is an appropriate time to consider such powers because the Soviet Union will suffer a substantial decline in hard currency earnings over the next five years, and Western credits will be needed if Moscow is to maintain its purchases of Western machinery, equipment and technology (see Attachment C).

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SUBJECT: NSC Meeting on Senate Bill 812

-- In terms of targeting, however, it is not clear whether S. 812 is aimed properly. It should, perhaps, be broadened to cover those states that support terrorism such as Libya.

5. The meeting on Tuesday will focus on three options.

1. Giving Administration support to the spirit and intent of S. 812.

2. Having OMB announce that it will work with the Senate to craft legislation along the lines of the proposed bill.

3. Announcing that the Administration supports the spirit and intent of the bill, but saying that the Administration will use procedures short of legislation to achieve the same ends.

The Secretaries of Treasury, State, and Commerce oppose the controls contined in S. 812, arguing that they would be ineffective. Defense, OMB, and perhaps, NSC are in favor of some powers along the lines of S. 812, although not necessarily in the form provided in the bill.

25X1

Attachments:
A. Talking Points
B. Senate 812
C. USSR: Declining Hard Currency Earnings
D. Eastern Europe Boom Market
E. Soviet Oil: Gorbachev's Alternatives

SUBJECT: NSC Meeting on Senate Bill 812

Acting NIO/Econ [redacted] 25 October 1985 NIC 05356-85 25X1

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By Mr. GARN (for himself and Mr. PROXMIRE):

S. 812. A bill to amend the Export Administration Act of 1979 to authorize controls of the export of capital from the United States; to the Committee on Banking, Housing, and Urban Affairs.

FINANCIAL EXPORT CONTROL ACT

● Mr. GARN. Mr. President, today I am introducing the Financial Export Control Act, a bill authorizing the President to control the transfer of money and other financial resources from the United States to countries against which we maintain national security export controls.

For the past 3 years the Congress has been reviewing the Export Administration Act in an effort to improve our ability to prevent the transfer of sensitive goods and technology to our adversaries. The Defense Department recently commissioned a private study of the impact of technology transfer on our defense spending. That study, which will soon be released, confirms what we have long feared, that technology transfer to the Soviet bloc costs us tens of billions of dollars annually in increased defense costs.

Mr. President, although a bargain in comparison with our development costs, the Soviets have to pay for the technology they obtain. It is unfortunate but true that the Soviets are successful in gathering Western technology with the help of people living in the Western democracies. But that help has to be bought. In fact, the Western high technology smuggler demands a premium price for everything he delivers, and he will not take payment in rubles. This means, Mr. President, that the Soviet ability to obtain the sensitive goods and technology from the West that are turned against us in Soviet weapon systems is directly related to their ability to obtain hard currency, Western currencies.

There are only a few ways that the Soviets can obtain hard currency. They can export to the West, but the quality of Soviet products is so low that export sales have been limited to exports of raw materials, such as gold and natural gas, and to arms exports.

The other way that the Soviets have in the past obtained what is for them very scarce Western currency is through loans from Western banks. This source largely dried up, however, over the inability of Poland and several other Soviet allies to pay their debts and the furor caused by the realization that Western banks were so deeply involved in lending to the Soviet bloc at the same time that these countries were brutally repressing their own citizens.

Lately, however, Western European banks have resumed their lending to the Soviet bloc. The level of lending reached $3 billion last year, a threefold increase over 1983. The only bright spot in this gloomy picture was the fact that U.S. banks were staying out. Now that, too, is ending. American banks are now falling over each other to get back into lending to the Warsaw Pact, and at terms far more favorable than what the Western Europeans were offering. Last year, while West German banks were making largely short-term loans to East Germany at rates 3 or 4 percentage points over the London Interbank offered rate [LIBOR], First Chicago Bank gave the East Germans a $75 million loan at only 1 point above LIBOR. The Western Europeans have since begun matching these terms.

Not to be outdone, however, New York's Citibank is currently syndicating a loan to East Germany in the amount of $500 million, at seven-eighths of a point above LIBOR or one-half point above the U.S. prime rate. This loan started out at a mere $150 million, but there was such enthusiasm for it from U.S. banks that the East Germans were persuaded to increase the amount. Moreover, this loan is for 7 years, with a built-in 3-year grace period.

Mr. President, the prime rate is currently at 10.5 percent, so the Citibank loan to East Germany, in today's terms, would be for a rate of 11 percent. I wonder whether any of my colleagues have any constituents that would like to borrow money at 11 percent. Do they have anyone who would like to buy a home at 11 percent, or obtain credit for farm improvements at 11 percent? Perhaps they have some constituent that would like to start or expand a business with an 11-percent loan, or make an export sale. They very well may have such people, but they are unlikely to find those kinds of loans being offered. Apparently, a family trying to buy a home, a farmer, a businessman in the United States cannot easily get such a rate, but the East Germans can.

What are the East Germans going to do with such a loan? Are they going to expand human freedoms, increase individual opportunity? No. Instead, the East Germans are going to use the money to buy Western high technology. They are concerned by the fact that their Communist economy is falling farther and farther behind the economy of West Germany—and it is worth adding that the East Germans came to Citibank because the West German banks were requiring human rights concessions for the granting of their loans.

The East Germans are also eager for Western technology because their Soviet masters are demanding more high technology imports from the East Germans in exchange for Soviet energy supplies. That is to say, although the loan is going to the East Germans, its benefits are going to the Soviets.

Mr. President, I am not sure how we can best deal with this problem, but I do know that we are making our export control task all the more difficult by lending our adversaries the money with which to obtain our technology. This is a practice that must stop. Our banks may make some profits from the loans, although their troubled East European loan portfolio casts some doubt on that. But whatever profit they may obtain is far short of the expense that it causes us to make up for Soviet bloc military advances made possible by Western technology. What would interest rates be for our people if we could safely decrease defense spending by tens of billions of dollars annually? We cannot make such cuts, however, as long as we are contributing so directly to Soviet bloc military advances.

I am offering this bill today for consideration by my colleagues in hopes that it will lead to an end to the practice of lending to our adversaries. This bill authorizes, but does not direct, the President to control transfers of capital to countries against which we maintain national security export controls, the Soviet bloc countries. The President would be given full discretionary authority so as to apply such controls in the manner most in keeping with our national interests.

The bill in its current form is a discussion draft. My colleagues may have some other ideas, and some changes may need to be made. Perhaps the problem can be solved without legislation, but I believe that the time has arrived to address this situation directly.

Mr. President, I would also like to mention to my colleagues that I do not intend to add this bill to current proposals to amend the Export Administration Act that are being considered here and in the House of Representatives in connection with the reauthorization of the Export Administration Act. This is a separate item of legislation.

Mr. President, I ask that the text of an article from the March 19, 1985, edition of the Wall Street Journal that details the recent Citibank loan, along with the text of the bill and a section-by-section analysis of the bill, be included in the RECORD at this point.

There being no objection, the material was ordered to be printed in the RECORD, as follows:

[From the Wall Street Journal, Mar. 19, 1985]

EAST GERMANS BENEFIT FROM U.S. BANK CREDITS THAT DON'T CALL FOR HUMAN-RIGHTS CONCESSIONS

(By Frederick Kempe)

EAST BERLIN.—American bankers' eager resumption of credits to East Germany is helping the country avoid human-rights concessions in its financial relationship with West Germany.

East Germany avoided a Polish-like financial crisis in 1982 and 1983 through two separate credits negotiated and guaranteed by Bonn and extended by West Germany banks. In return, East Germany eased restrictions on West Germany visits to the East, and it also last year allowed 40,000 East Germans to emigrate to West Germany.

Western experts now believe that East Germany yielded the short-term human-rights concessions to pursue significant longer-term aims that would spare it from such a vulnerable political position again. It combined the West German credits with a strict austerity program and dramatic import reductions to considerably improve its economic performance and its image among international creditors, who now are competing to give the country money.

CHANGE OF COURSE

Bank of America, Manufacturers Hanover and Citicorp, who were refusing East Germany new credits a little more than a year ago, are managing with the bank of Tokyo a $150 million credit that has grown to $800 million largely due to U.S. banks' demand. The loan hasn't any political strings attached, and its terms are the best East Germany has seen since the Polish repayment crisis—⅞ percentage point over the London Interbank Offered Rate (Libor) or an option for ½ percentage point over the U.S. prime rate. It is to be repaid over seven years with a three year grace.

"It's all a political business," says Wolfgang Seiffert, economic adviser to the East German government until 1978, and now a professor in Kiel, West Germany. "The attempt of East Germany to get money from American and other banks is an effort to get western finances without liberalization measures. The money will give East Berlin a stronger hand for its political games with West Germany because it doesn't need Bonn's money as much anymore."

West German bankers also complain that the Americans have been driving prices down in their effort to get back into the East Germany lending market that they abandoned in 1981, when Poland cast a shadow over all of Eastern Europe.

Until last year, West German banks were extending the East Germans primarily commercial loans, usually to be repaid after one year at a rate three to four percentage points above Libor. However, East Germany extracted far better conditions from First National Bank of Chicago when it worked its way back into the market last year. First Chicago offered a $75 million club loan at only one percentage point above Libor, a rate that European banks thereafter were forced to match despite a feeling by many lending officers that the margin wasn't sufficient.

THE GROWING GAP

U.S. banks are injecting money into the East German economy at a critical time. East Germany considerably reduced imports over the past three years to achieve hard currency trade surpluses and to service debts, but it also dangerously reduced investment. The result was that the technology gap between it and its West European neighbors grew.

Western economists expect the next East German five-year plan, from 1986-1990, to include an ambitious investment program, particularly emphasizing purchases of Western technology.

This is partially a response to a Soviet ultimatum that Moscow is to get Western-quality goods in exchange for the raw materials it provides Eastern Europe, or Moscow will reduce the amounts provided. The Soviets warn that Soviet oil can simply be sold on Western markets and the proceeds used to buy more advanced Western products.

"The East Germans are the largest East European technology sluice and supplier for the Soviets," says Klaus Schroeder of the West German government-sponsored Institute for Science and Policy near Munich. "Soviet demands have put a large amount of pressure on the East Germans to modernize their industry."

GOOD PERFORMANCE

U.S. bankers argue that they have good reason to be wooing the East Germans. First, they say East Germany's economic performance is the best in Eastern Europe. Produced national income (basically, gross national product minus invoices) in 1984 rose by 5.5%, compared to 4.4% the year before. Net industrial production rose 8.5% against 4.0% in 1983. Industrial labor productivity increased 7.7% against 5.8% in 1983.

The bankers also cite a radical improvement in East Germany's external position. While East Germany's debt to Western

banks of $10 billion once was worrying to the banks, they now place more emphasis on East Germany's buildup of deposits in Western banks to some $4.5 billion.

Some also argue that a double umbrella exists over East Germany. They say the Soviets wouldn't allow their most important economic ally to enter into repayment difficulties and hence would bail the East Germans out. The bankers are even more confident about a West German umbrella, following Bonn's financial intercession during East Germany's recent problems.

"The proof is in the pudding," one U.S. banker says. "East Germany is a solid bet. We have been aggressively adding to our exposure."

However, many Western experts believe the banks are making the sorts of errors they did when more than 400 lending institutions scrambled in the 1970s to do Polish business. They are competing to give East Germany even more cash than it is asking for, yet East German economic reporting remains imprecise. The bankers haven't any specific idea what East Germany intends to do with all the money, nor whether it can eventually earn the hard currency to repay the loans.

"Bankers learn very slowly and forget very quickly," says Mr. Schroeder, a former bank economist.

Says Mr. Seiffert, "The economic situation in East Germany has improved, and so no one should have great worries about giving the country credits, but the U.S. banks currently aren't being prudent enough and should only extend credits when linking them to specific projects or investment plans."

SECTION-BY-SECTION ANALYSIS OF THE FINANCIAL EXPORT CONTROL ACT

Section 1 gives the title of the legislation as the Financial Export Control Act.

Section 2 adds to the Export Administration Act of 1979 (EAA) a finding that loans and transfers of capital to the Soviet Bloc add to their ability to acquire sensitive goods and technology.

Section 3 adds to the EAA a statement of policy to restrict transfers of capital to controlled countries in order to further national security export control policies.

Section 4 adds to the EAA a new section 5A, authorizing the President, through the Secretary of the Treasury, to control transfers of capital to controlled countries, and directing the Secretary of the Treasury to conduct negotiations with other countries to obtain cooperation on any such controls imposed.

Section 5 is a conforming amendment, designating the Treasury Secretary as responsible for issuing licenses that may be required for capital transfers to controlled countries.

Section 6 authorizes the Secretary of the Treasury to enforce the controls on transfers of capital to controlled countries.

Section 7 is a conforming amendment to the reporting provisions of the EAA, requiring the Treasury Secretary to issue a report on capital controls, as part of the annual report on export controls submitted to the Congress by the Commerce Secretary.

Section 8 gives the Treasury Secretary the authority to issue regulations.

Section 9 contains definitions.

S. 812

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Financial Export Control Act".

SEC. 2. Section 2 of the Export Administration Act of 1979 is amended by adding at the end thereof the following:

"(10) Loans and other transfers of capital to the Soviet Union and its allies from public and commercial sources significantly increase the ability of those countries to obtain sensitive goods and technology, thereby damaging the security interests of the United States and its allies.".

SEC. 3. Section 3 of the Export Administration Act of 1979 is amended—

(1) in paragraph (2)(B), by striking out "and" after the semicolon;

(2) in paragraph (2)(C), by striking out the period and inserting in lieu thereof "; and "; and

(3) by adding at the end of paragraph (2) the following:

"(D) to restrict the export of capital, the extension of credit, the making of loans, or the transfer of financial resources to destinations to which exports are restricted in order to carry out the policy described in subparagraph (A) of this paragraph.".

SEC. 4. The Export Administration Act of 1979 is amended by inserting after section 5 the following new section:

"CAPITAL CONTROLS

"SEC. 5A. (a) AUTHORITY.—In order to carry out the policy set forth in section 3(2)(D) of this Act, the President may prohibit, curtail, monitor, or otherwise regulate the export or transfer, or participation in the export or transfer, of money or other financial assets, including the making of a loan or the extension of credit, to the government of any controlled country, or to any political subdivision thereof or any organization or association owned by or acting for or on behalf of such government or political subdivision thereof. The authority contained in this subsection shall be exercised by the Secretary of the Treasury, in consultation with the Secretary of Defense, the Secretary of Commerce, and such other departments and agencies as the Secretary of the Treasury shall consider appropriate.

"(b) NEGOTIATIONS WITH OTHER COUNTRIES.—The Secretary of the Treasury, in consultation with the Secretaries of State, Defense, and Commerce, and the heads of other appropriate departments and agencies, shall be responsible for conducting negotiations with other countries regarding their cooperation with controls imposed pursuant to subsection (a).".

SEC. 5. Section 10 of the Export Administration Act of 1979 is amended—

(1) in subsection (a)(1), by striking out "All export license applications" and inserting in lieu thereof "Except as provided in subsection (k), all export license applications";

(2) in subsection (j)(1), by inserting before the period ", except in the case of any license that may be required pursuant to section 5A of this Act, in which case the Secretary of the Treasury shall establish such procedures"; and

(3) by adding at the end thereof the following new subsection:

"(k)(1) Any export license applications required pursuant to section 5A of this Act shall be submitted by the applicant to the Secretary of the Treasury. All determinations with respect to any such application shall be made by the Secretary of the Treasury.

"(2) To the extent necessary, the Secretary of the Treasury shall seek information and recommendations from the Government departments and agencies concerned with aspects of the United States domestic and foreign policies and operations having an important bearing on the policy set forth in section 3(2)(D) of this Act.".

SEC. 6. Section 12 of the Export Administration Act of 1979 is amended—

(1) in the second sentence of subsection (c)(1), by inserting before the period the following: ", or in the case of information obtained with respect to section 5A of this Act, unless the Secretary of the Treasury so determines"; and

(2) in subsection (e), by striking out "The Secretary" and inserting in lieu thereof "Except with regard to the authority provided under section 5A(a), the Secretary".

SEC. 7. Section 14(a) of the Export Administration Act of 1979 is amended—

(1) by striking out "and" at the end of paragraph (19);

(2) by striking out the period at the end of paragraph (20) and inserting in lieu thereof "; and"; and

(3) by adding at the end thereof the following:

"(21) actions taken by the President and the Secretary of the Treasury to carry out the policies set forth in section 3(2)(D) of this Act, as described by the Secretary of the Treasury in a report submitted for inclusion as a part of the Secretary's annual report required by this section.".

SEC. 8. Section 15 of the Export Administration Act of 1979 is amended by inserting "and the Secretary of the Treasury", after "Secretary".

SEC. 9. Section 16 of the Export Administration Act of 1979 is amended—

(1) in paragraph (4) by striking out "and" after the semicolon;

(2) in paragraph (5) by striking out the period and inserting in lieu thereof a semicolon; and

(3) by adding at the end thereof the following:

"(6) the term 'extension of credit' includes loans, credit sales, the supplying of funds through the underwriting, distribution, or acquisition of securities, the making or assisting in the making of a direct placement, or otherwise participating in the offering, distribution, or acquisition of securities; and

"(7) the term 'loan' includes any type of credit, including credit extended in connection with a credit sale.".

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ATTACHMENT C

25 October 1985

USSR: Declining Hard Currency Earnings

Declining oil production in West Siberia is worsening an already poor outlook for Soviet hard currency exports during the rest of the 1980s.

-- A slowdown in oil exports to the West could cause a drop in Soviet hard currency earnings of 30 percent or more by 1990.

The Soviets have a limited number of options to deal with reduced export earnings.

-- Moscow could divert oil and other export goods from Eastern Europe and sell to the West in exchange for hard currency, but at the risk of alienating its allies.

-- The Soviets could cut back on hard currency imports from the West, although imports are crucial to the development of various sectors of the economy such as manufacturing, agriculture and, notably, petroleum.

-- Moscow also could increase foreign borrowing from Western banks, an option it previously has taken on only a limited basis.

Raising funds on the international capital markets would be the easiest of these options.

-- The USSR is considered creditworthy by Western banks, relative to most LDC borrowers, and most banks would certainly be eager to take on additional Soviet exposure.

-- Soviet creditworthiness could be even further enhanced by verification and start of development of the oil potential of the Barents Sea.

-- Moreover, the Soviets are experienced at dealing with Western bankers and would probably be able to obtain very favorable loan terms.

Within the past few months we have seen a rapid increase in borrowings by Eastern Europe. Despite difficult economic conditions in many of these countries, Western bankers see them as a profitable outlet for funds to replace credits formerly made to Latin America (see Attachment D).

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Washington, D.C. 20505

National Intelligence Council

NIC 04945-85
2 October 1985

MEMORANDUM FOR: Herbert E. Meyer
Vice Chairman, National Intelligence Council

FROM: [redacted] 25X1
Acting National Intelligence Officer for Economics

SUBJECT: Soviet Oil: Gorbachev's Alternatives

1. Community analysis of Soviet oil problems to date has focused on the possibility that there would be a significant decline in Soviet oil production and related hard currency export earnings.

-- A March 1985 SOVA paper used as a "worst case" scenario a decline in production to 11 million b/d by 1990 (from a 1983 peak of 12.3) and a $10 billion loss in real hard currency earnings, implying a reduction in total earnings of roughly one-third.

-- In the "best case" gas scenario, natural gas exports could only make up a fraction of this loss.

2. Events so far in 1985 have overtaken these "worst case" estimates.

-- Oil production is running 4% or roughly 500,000 b/d below last year's levels and exports to many firms in Western Europe are already being reduced by one-third to one-half.

-- This decline in production continued throughout the summer despite a major effort that began early this year to repair out-of-service wells. Equipment shortages have prevented any headway in this effort.

3. While it is still possible that Gorbachev's efforts to throw more resources at the problem will slow the rate of decline for a time, we must now consider the repercussions of a failure of this effort. The oil problems pose some real challenges for Gorbachev.

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SUBJECT: Soviet Oil: Gorbachev's Alternatives

-- Absent the oil decline, Gorbachev could have continued to use traditional measures to flog an additional percentage point or two of growth from the economy over the next year or two. This would have given him time to consider and, perhaps, set the stage for more radical systemic changes down the road.

4. The oil decline forces his hand and, absent an unexpected leveling off in production, will make him consider more radical solutions. His options for dealing within the system seem limited.

-- Deep-rooted problems prevent delivery of adequate equipment to prevent further oil production problems. On-site management problems compound the difficulties.

-- Similar systemic problems prevent progress at "conservation" in industry and the economy in general.

-- Gas substitution faces the same difficulties, although we are less sure about the potential for further inroads here.

-- Additional cuts in oil deliveries to Eastern Europe could cause severe industrial problems and further injure the political relationship.

5. Short of a radical military solution, Gorbachev does have some high-risk bureaucratic options.

-- More imports of Western equipment and the introduction of Western technicians and, perhaps, management in oil fields.

-- Establishment of joint ventures with Western firms in the Barents Sea or elsewhere.

-- Enlisting Western help in gas substitution.

6. All of these alternatives carry an indeterminate payback in exchange for major systemic change, however. One key theme in the past has been optimism over the ability of the economy to respond on its own. Indeed, many will feel that by taking such options now Gorbachev would be admitting defeat before his economic reform program even got off the ground.

SUBJECT: Soviet Oil: Gorbachev's Alternatives

-- By failing to take radical action now, however, Gorbachev may be buying even more serious energy problems for the future and increasing the chance for a high-risk military solution.